DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

36 Letters per Year — $60.00 Annually

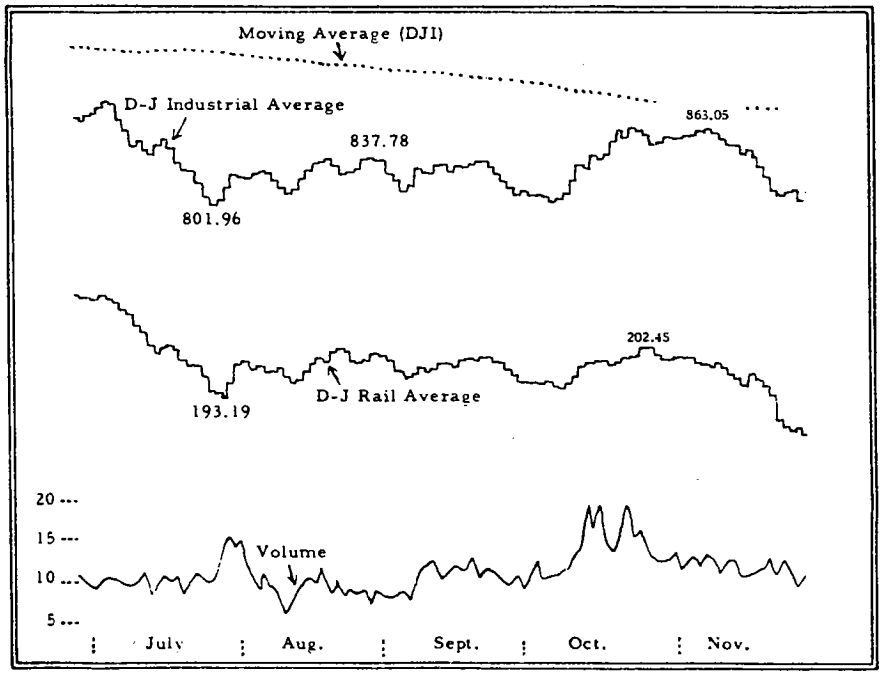
Registered with the Securities Exchange Commission

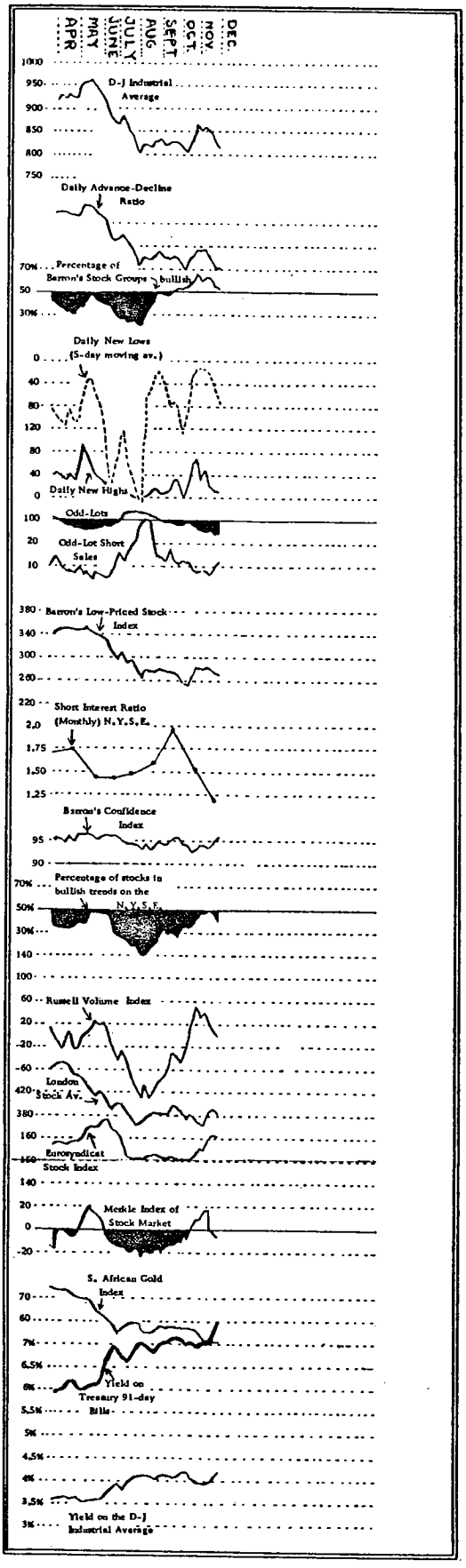
December 3, 1969 Letter 446

THE MARKET: On November 24 the Rail Average produced a rare downside gap, which means that the intra-day low for Rails on November 23 was above the intra-day Rail high for November 24. This type of downside gap-action in an Average is indicative of extreme weakness. Significantly, the weakness occurred in the carrier Average, the Average which, of all the Dow Averages, is the most sensitive to both speculative and economic influences. This is so because the Rail stocks tend to be heavily leveraged with debt, and any important changes in business (as reflected in rail carloadings) can easily produce wide and drastic swings in individual rail earnings. During the week ending November 28, in fact, Penn-Central omitted its dividend, and knowledge of this may have been instrumental in producing the downside gap in the Rail Average.

On November 21 the Rails broke to a new 1969 low, below the July 30 low of 193.19. So far, the new Rail low has been unconfirmed by the Industrial Average. Confirmation would require that Industrials penetrate their own July, 1969 low of 801.96. I feel that it will not be long before Industrials do confirm. But the late-November non-confirmation does set up the technical possibility of a rally, and we will have to see whether the Averages are able to produce anything constructive out of the non-confirmation over the period ahead. It seems to me that if the market cannot get a rally started during the next week or so, new lows for all three Averages will be produced before 1969 is out.

The advance-decline ratio dropped to substantial new lows for the year during the last week, and this suggests that on average the majority of N.Y.S.E. issues are now showing losses for 1969, even including those stocks purchased near the July low of 801.96 on the Dow. All of which point up the dangers of attempting to "beat the market" when the primary trend is bearish.

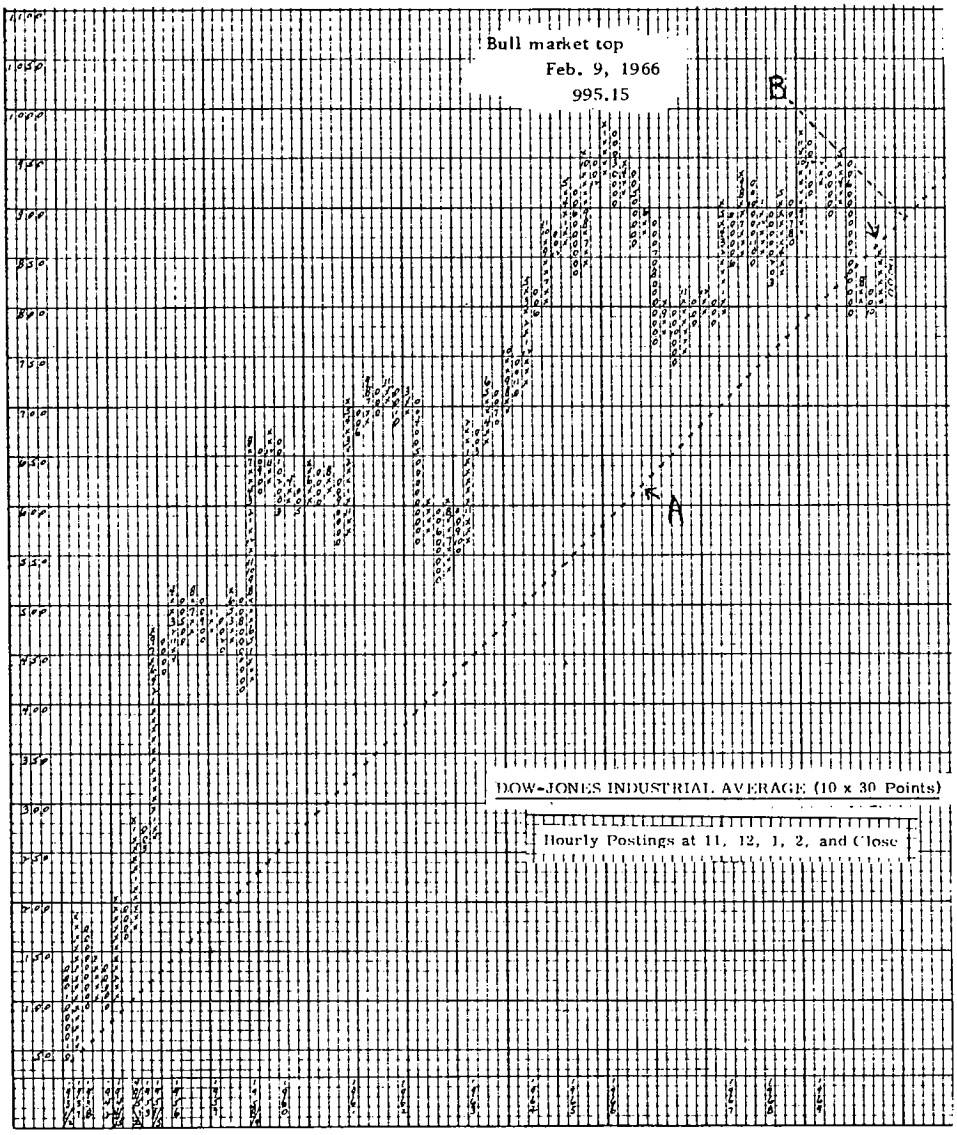




Much is being made of the current heavy odd-lot selling, but in reviewing odd-lot action of the past decade I note that there is a pronounced tendency for odd-lots to swing towards increased selling during the mid-November to mid-December period of each year. Therefore, I do not see the odd-lot picture as a technical plus at this time.

Sometime between the end of 1969 and early 1970, I expect the forces of inflation to collapse, and simultaneously bear market deflation should begin to envelope the nation. As a steep recession and later a depression take over, the Government will pull out every trick in the book. One of those tricks will be a doubling or a tripling in the price of gold. This will be a pleasant occurrence for holders of gold shares, but I warn subscribers that no trick, device or manipulation will stop this or any other bear market from expressing itself to the full. The stock market and the economy are drawing closer and closer to the grim clutches of the bear. Our job as investors and as intelligent citizens is to protect our assets. When the liquidation has reached its full height and finally exhausts itself, it is the people with assets who will turn the bear market around. I sincerely hope that my subscribers will be numbered among those who have the brains, nerve and means to buy "at the bottom."

POINT & FIGURE: I am updating the long-term P & F chart which I last published in Letter 443. This is a 10-point, 30-point reversal chart. This means that each box on the chart equals 10 points, and that only rallies or declines of a full 30 points or more are entered on the chart. The vertical rows of "X"'s indicate rallies, the vertical rows of "O"'s indicate declines. For example, if the Dow rallies from 800 to 831, a series of three X's are shown on the chart. If the Dow then drops to 788, the next vertical row is filled in the O's down to the 790 level. This type of charting allows for great compression, and thus we note on this chart that all 30 point rallies and declines since 1932 are shown.



In previous Letters I drew attention to the fact that the massive ascending trendline which began at the 1932 bottom was finally shattered during July, 1969. That trendline (marked A on chart) represented the reversal of a 37 year trend, a reversal which I consider to be of paramount importance. As soon as trendline A was penetrated, I wrote that I believed all forthcoming action, both rallies and declines, would take place below trendline A.

Note that on the recent November, 1969 recovery rally, the Dow stopped at 863.05 (November 10), and that this rally (arrow on chart) held just within the upper limits of trendline A. I have drawn in a new trendline, marked B on chart, and this is a bearish or descending trendline. The B trendline intersects the Dow at 890, and I would guess that any bear market rally from here (for instance, a "year-end rally") would be contained by the 890 level of trendline B.

On the downside, note that there are two recent O's at the 800 level. This sets up an important technical pattern. Any decline from here to the 800 level would set up a structure known as a "triple bottom." I have observed in the past that

the penetration of a compact triple bottom (such as the one which may now be forming) carries considerable force.

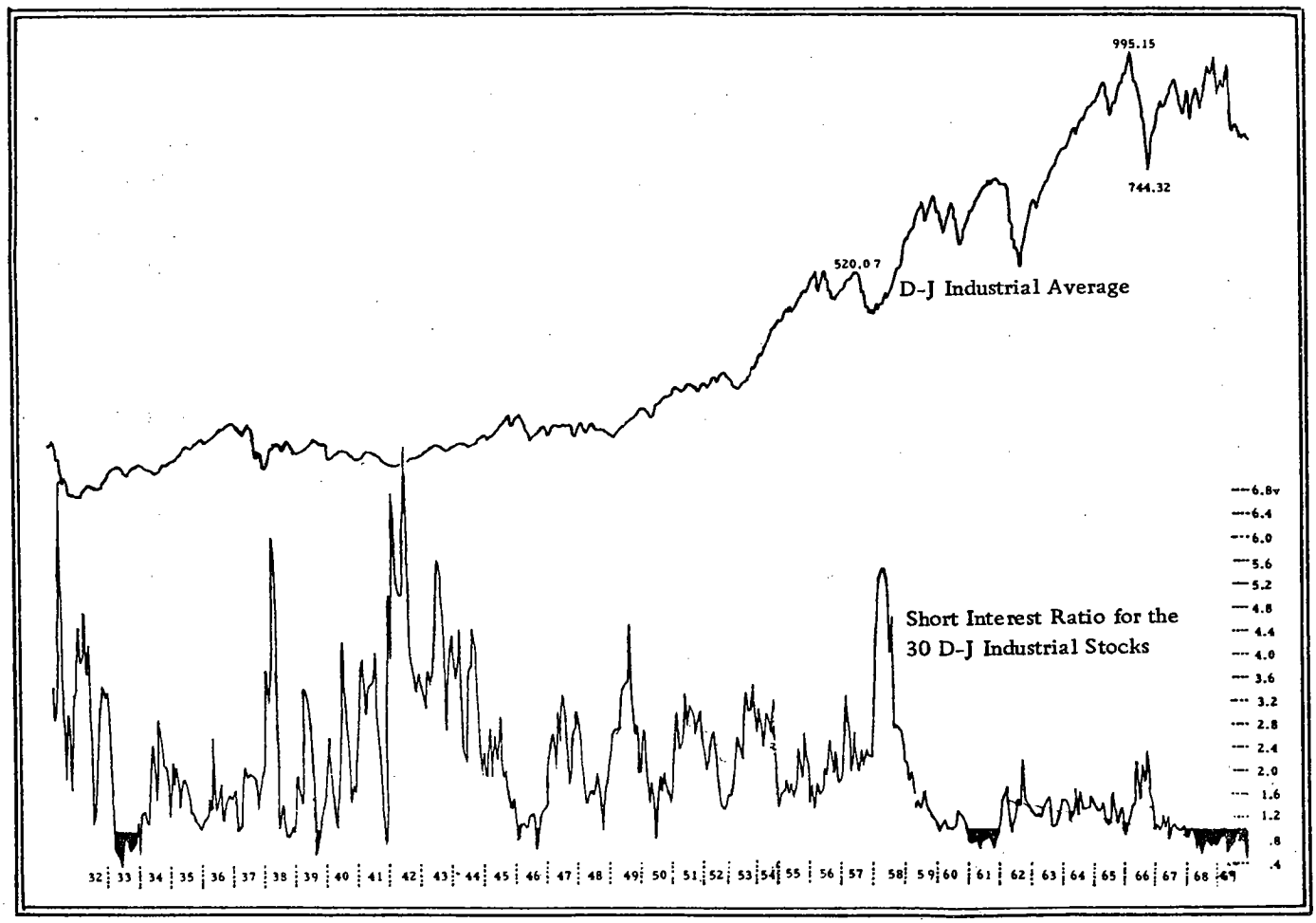
Therefore, I would take any hourly or closing figure of 790 on the Dow as ominously bearish. At 790 the Dow would have penetrated a triple bottom, and such action could easily send the Industrials down to and below the 1966 low of 744.32. From a P & F standpoint, 790 is the figure to watch.

Aside from the importance of the 790 level, I want to draw subscribers' attention to the huge "congestion area" which has formed following the 1966 high of 995.15. I see all the rallies and declines since the 1966 high as part of a giant area of distribution. As a general rule, the more "work" (rallies and declines) the Averages do prior to an important movement, the greater the extent and duration of that movement. For this reason, I would think that any forthcoming penetration of the 1966 low would be followed by a most critical decline. The long, tedious series of movements since the '66 high suggests it.

DOW SHORT INTEREST RATIO: Each month I try to fit in a section on the short interest ratio in the 30 Dow stocks. This is the indicator developed by my brilliant friend Bill Gordon of New York. As I have explained before, I like the Dow Short Interest Ratio (DSI) for a number of reasons: (1) It renders very few signals, (2) When it does give a signal, that signal is unmistakably clear, (3) The DSI has a very limited following, and one reason is that only Bill Gordon computes it.

In last month's review (which appeared in Letter 443) I stated that the DSI ".....is continuing to shout its warning." Letter 443 appeared on October 31. On that day the Dow closed at 855.99. I am sorry to report that the latest (mid-November) reading for the DSI is considerably worse than the October figure.

Between mid-October and mid-November the total short interest in the 30 Dow Industrials dropped from 727,000 to 597,000. When computed as a ratio of the volume in the 30 stocks during the same October-November period, we find that the DSI reading for mid-November is .58.



 Now I am repeating my long-term chart of the DSI (see page 3) which traces this indicator from the year 1931 to date. In 1933 the DSI dropped under the critical 1.0 zone for a period of eight months (black area on chart), and this was followed by the panic of July, 1933 to July, 1934. The second area of extremely bearish readings occurred during 1961. The DSI held under 1.0 during every month of 1961 plus the month of January, 1962. Most subscribers remember only too well the drastic decline which took place during 1962.

So much for history. On January, 1968, the DSI sunk below 1.0 to a reading of .85. In the 23 months since January, 1968, the DSI has held under 1.0 on all but two months (those two months were March, 1968 with a DSI of 1.13 and September, 1969 with a DSI of 1.04). But taken any way you like it, a string of 21 out of 23 months in which the DSI is under 1.0 is the most ominous series in the 38-year history of this indicator.

The lowest reading in the annals of the DSI occurred during June and July of 1933 with two successive figures of .56 and .37. Those figures preceded a panic. The next extreme low reading came in July, 1968. That figure was .53, and it was followed by a 60 point drop in the Dow. The next extremely low DSI reading was seen in May, 1969, as the indicator fell to .59. In the next few months the Industrial Average declined over 100 points.

All of which brings us up to the present. The latest reading of .58 (mid-November) constitutes the fourth lowest individual monthly reading since 1931. I find the .58 figures particularly ominous since it has come (as stated before) within the longest string of under-1.0 tabulations in DSI history.

Conclusion: The DSI is an important indicator which has a very limited following. Only Dow Theory Letters publishes the historical DSI chart. The latest black area on the chart (under 1.0 readings) is the most extensive in history. The chart is saying that there are too few shorts in the 30 Dow Industrials (in relation to today's volume) to indicate anything but a period of extreme technical weakness. Let's put it another way. We are now in a primary bear market, but in view of this there are pitifully few shorts in the 30 Dow stocks. Those who trade in the 30 Dow stocks are far too optimistic as evidenced by a short position of only 597,000 shorts in the 30 Dow stocks. Optimism during a bull market is, in general, all right since such optimism is at least in harmony with the primary (bull) trend. But optimism during a primary bear market is the road to ruin. It indicates a condition of severe technical weakness, and that, according to the DSI, is exactly where we are now.

INFLATION AND DEFLATION: If all the current anti-inflation measures sponsored by the Administration and the Federal Reserve Board were taking place within the context of a primary bull market, the Gods would be smiling. For if the primary trend were now bullish, any anti-inflation measures would simply serve to extend and prolong the life of the bull market. Personally, I am convinced that Mr. Nixon and the Fed consider the current period essentially no different than 1957 or 1960. They believe that they are now doing what should have been done years ago, and in that they are correct.

But if the Gods are smiling today, they are smiling out of sentiments of pity or irony. The Fed and the Administration are trying bravely and valiantly to stem the forces of inflation, but there is an ominous difference between the situation today and that of 1953, 1957, 1960 or even 1962. The difference is that the primary trend is now bearish. How do we know this, how do we know that a primary bear market is in progress? Believe me, if it were not, the fantastic inflation of the past four years would have sent the Industrial Average surging above its February 9, 1966 bull market high of 995.15 to a level of 1500 or 2000. But look at what has happened. With record earnings and GNP during 1967 and 1968, with rampant inflation continuing during 1969 and right up to this writing, we find the Dow almost 200 points under its 1966 high, while the Rail Average is actually under its 1966 low.

The persistence of inflation during 1969 has been astounding. It has all the power of the last charge of a fighting bull, a bull who has the sword deep in his chest but who attacks the muleta to within a second of his death. Make no mistake about it, the Administration and the Fed are going to win their fight against inflation. I don't have any doubt of that. What bothers me is what is going to happen when the forces of inflation expire and a deflation fully as vicious as today's inflation sets in. Yes, I believe that the irony of the situation is going to be that when deflation finally sets in, neither the Administration, the Treasury nor the Fed is going to be able to turn it around.

Look at what's happening now. The bond market, suffering under severe monetary restrictions, is in shambles. The bellwether Treasury bond, the 4¼'s of 1987-92 has broken 70 for the first time since issuance. The D-J 40-Bond Average has sunk under 70 for the first time in history. Treasury bills (91-day bills) set an historic yield record last week of 7.47% while the companion 26-week bills touched a yield of 8% for the first time since Treasury bills were issued in 1937. "A" rated Utility bonds were going for 9% yields, and the yields on Municipal bonds were breaking all records. Yet in the face of this incredible performance in the money market, inflation and optimism still rein. For instance, last week, the day that the Treasury bills touched historic highs, nickel prices were given the biggest boost since the Depression.

Imagine the predicament if the situation were reversed, if deflation were to become as persistent as today's inflation. And that is just what I think we're going to witness starting some time in 1970. Once the inflation ball is arrested and deflation takes over, then all the machinations of all the Government's brain-trusters and agencies aren't going to turn the economy around until the deflationary forces are fully exhausted.

In other words, I expect today's inflation, with the aid of the Administration and the primary bear market, to be fully reversed in coming months. Furthermore, I would say that the market's recognition of the rise of the forces of deflation will come in two steps, the first a breaking of the 800 level and the second and more decisive step, a penetration by Industrials of the 1966 low of 744.32.

As I was writing this, I was reminded of the 1937 obituary notice which Robert Rhea (the great Dow Theorist of the 1930's) wrote for the 1932-1937 bull market: "Government with all its power can't control even the Mississippi River, much less the tides of American business sentiment. Government money policies, if constructive, can help a bull market but can't stop a bear market." Within the framework of the current situation, Rhea might have written, "Government monetary policies can stop a bear market rally, but they can't reverse a bear market decline."

Already, we are receiving hints of a business slowdown, and along with it the seeds of deflation. Housing starts are way down, auto sales are turning sluggish, corporate profits during the third quarter were down $3 billion, the first drop since early 1967, gains in personal income are slowing, industrial production down three months in a row, manufacturers' inventories at a record high, unemployment creeping up. Thus the trend of business is not clearly down, but the upward momentum is ebbing. If the Dow breaks below 800 and then below 744.32 I would expect business to turn down rapidly and within six months the downturn should reach epidemic proportions.

One of the famous economists who has been right on the market and the economic picture to date is Eliot Janeway. In his latest report, Janeway debates the question of where the Dow is going in terms of money rates and official intervention. "But the question now," he states, "is whether the coming break below 800 will surface enough realism to hit bottom closer to 800 than to the 1966 low of 733 which I have been regarding as the serious testing point. The 1966 break hit bottom at the 733 level not because it is a magic number, but thanks to the political pressures which caused money rates to top as the market was plunging under 750 on its way to 725. I doubt that any replay of the same salvage operation can realistically be expected to put a bottom under the stock market. It is headed under 800 while credit market rates are still far from pumping against any ceiling." Read and re-read Janeway's last sentence. It is probably the essence of the near-term picture for the market.

QUESTIONS: I really hesitated about writing this section. You might call it a piece with only my instinct to back it, but here goes. I'm increasingly apprehensive about the way things are going in this country. I have been talking about the "split" building up between the conservatives and the liberals (and radicals), and I see that split widening almost daily.

I guess the latest "alarm-bell" to ring in my mind is the whole Spiro Agnew spectacle. The Vice President (I must presume with the tacit consent of the President) is now attacking the news media. Now, I have never been satisfied with the way news is covered in this nation. Men write news, and every man has emotions. There is no way in the world to write a news story with complete honesty. You can lie by intent, you can lie by omission, you can lie because emotionally you are unable to accept a fact that the next man will not only accept but will enlarge.

Therefore, one has to go by instinct. One has to ask himself after reading or hearing a news story, (1) Does this man have the mental capacity or the knowledge to see the full implications of what he is writing? (2) Is this man neutral, or is it his intent to slant the news to his own or his employer's viewpoint? (3) Was this article "edited" in such a way as to leave out pertinent facts, or was it presented fairly by the media?

Mind you, I admit that it is almost impossible to present the news in an utterly fair way. Who can write a piece about Vietnam without interjecting his own opinion or bias? Who can write about gold without leaving out salient facts or without slanting the article towards his own personal opinion regarding the "barbarous relic."

Nevertheless, I am appalled by the spectacle of the Vice President attacking the news media. It was not a reasoned unbiased attack aimed at producing more truth in the press. Necessarily, when a man in a position next to the President of the United States attacks the news media, a threat is involved. What does this threat mean? Why was it so blatant? What power stands behind the threat? Does anyone have the strength to stand up against this kind of threat?

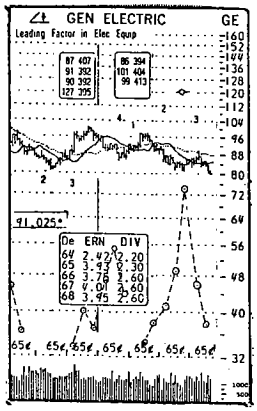
The point is that everybody knows that there has to be bias in the press. But I have always worked on the assumption that if one reads enough in all areas, somehow one can come up with enough answers so that he can put the facts and the story together, thereby arriving at the truth.

I don't want to silence the left, I don't want to silence the right. I don't want to silence the great center, or force them to think twice or three times before they print a story, no matter how biased I think it is. I want all the opinions, truthful or crazy. I want to decide who's telling the truth, who's lieing, and who's trying to tell the story the way he sees it.

Therefore, any threats to the press bother me. And when threats come from the highest offices in the land, it bothers the devil out of me. It's the people's right to decide whether what they read is the truth or a lie. If they can't make that decision, then Democracy is a farce. Pressure on the news media from high places is scary and ominous. My instinct is saying "Watch out, something is happening that bears watching. It smacks of danger and ugly power. It's making the hair on the back of my neck stand up." That's what my instinct is saying. Maybe yours is saying something different.

STOCKS: On the week ending November 28 there were 12 new highs and 303 new lows on the N.Y.S.E. Figuring that around 1700 assorted issues trade on the Big Board, this means that about 20% of all N.Y.S.E. issues slid to new lows for the year during the week ending November 28. Now surprisingly, during the same week 12 of the 30 Dow Industrial stocks broke to new 1969 lows. This come out to 40% of the Dow stocks. Thus, it seems to me that the Dow stocks, in terms of depth of weakness, are leading the N.Y.S.E. down.

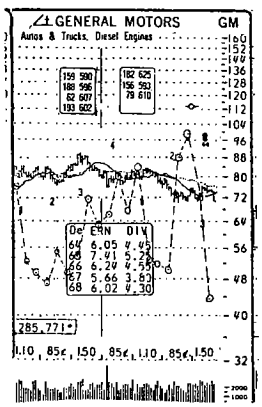
On December 1, General Electric broke the 80 level, a level which was discussed in the last Letter. Now ordinarily, the old "bull market adage" goes like this, "Don't sell on strike news." Why, then, did GE in the face of a continuing strike, penetrate its 1966 low and sink to its lowest level since 1964? It seems to me that this action is indicative of severe trouble for GE in the period ahead, trouble which will not be straightened out by a simple strike settlement. The market is saying that GE is in fundamental trouble, so much so that the stock has dropped back to its level of five years ago.



It is also clear that GE is the spearhead for the anti-inflation forces, and that GE's confrontation with labor is being scrutinized by all American industry. The Administration is staying out of the fight, and by so doing they are lending tacit support to GE's tough policy. As to the significance of the break below 80, refer to the chart in the last Letter or refer on a shorter-term basis to the accompanying weekly chart from Quote Digest, 110 N. Lorraine, Wichita, Kansas.

From the group standpoint, last week's action was not hopeful. Six of Barron's 35 stock groups fell to new 1969 lows, and these six included Aircraft, Autos, Oil, Steel, TV and the Rails. This was the worst showing in six weeks. Except for TV, all the new lows in the groups are particularly ominous since they are "heavy-goods" groups, the kind of groups that make booms and recessions.

A last word on stocks. General Motors is around the 70 area, with its really critical point the 66 area of 1966. Therefore, for another "fine-tuning" on a bellwether stock, I suggest we watch GM for a possible penetration through 66 to 65 even. At 65 I feel GM would be providing an ominously bearish signal for the Auto industry and for the stock market in general.



LATE NOTES: About every observer in the nation has stated that there is no significance to the 800 level in the Dow. So being contrary, I'll guess that there is a real psychological significance to that level, and I believe that if the Dow closes below 800 many speculators and investors will be disheartened. As this is written (morning of December 2nd) the Dow is within 2 points of 800, and I have no idea whether 800 will hold or not. However, the 800 level has been approached four times since the July 30 low, and I am afraid that I would attach importance to the violation of this widely-watched level. The accepted "theory" is that the Dow will dip temporarily below 800, "fool everybody," then rally back strongly above 800 again. Maybe.....

ANNOUNCEMENT: New address for Dow Theory Letters, P.O. Box 1759, La Jolla, Calif. 92037
All correspondents please change your files accordingly.